

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

**A REVIEW OF THE
LOS ANGELES UNIFIED SCHOOL DISTRICT'S
PROCUREMENT PRACTICES AND
CONTROLS OVER PROPERTY**

REPORT BY THE
OFFICE OF THE AUDITOR GENERAL

P-721

A REVIEW OF THE LOS ANGELES UNIFIED
SCHOOL DISTRICT'S PROCUREMENT
PRACTICES AND CONTROLS OVER PROPERTY

DECEMBER 1987



Telephone:
(916) 445-0255

STATE OF CALIFORNIA
Office of the Auditor General

660 J STREET, SUITE 300
SACRAMENTO, CA 95814

Thomas W. Hayes
Auditor General

December 22, 1987

P-721

Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the Los Angeles Unified School District's procurement practices and controls over property. Our audit did not identify any major breakdowns in the district's controls over purchases and property. However, some structural weaknesses have exposed the district to higher costs and loss of property in a few areas. Our report indicates that the district did not have adequate controls for procuring some of its supplies and equipment, that the district did not always control its highly desirable and portable property, and that the district did not always obtain competitive estimates for its purchases of \$21,000 or less.

Respectfully submitted,


THOMAS W. HAYES
Auditor General

TABLE OF CONTENTS

	<u>Page</u>
SUMMARY	S-1
INTRODUCTION	1
AUDIT RESULTS	
I THE DISTRICT'S CONTROLS IN PROCURING SOME OF ITS SUPPLIES AND EQUIPMENT WERE INADEQUATE	7
CONCLUSION	13
RECOMMENDATION	14
II THE DISTRICT DID NOT ALWAYS CONTROL ITS HIGHLY DESIRABLE AND PORTABLE PROPERTY	15
CONCLUSION	22
RECOMMENDATIONS	23
III THE DISTRICT DID NOT ALWAYS OBTAIN COMPETITIVE ESTIMATES FOR ITS PURCHASES OF \$21,000 OR LESS	25
CONCLUSION	30
RECOMMENDATION	30
RESPONSE TO THE AUDITOR GENERAL'S REPORT	
Los Angeles Unified School District	33
AUDITOR GENERAL'S COMMENTS ON THE LOS ANGELES UNIFIED SCHOOL DISTRICT'S RESPONSE	37

SUMMARY

RESULTS IN BRIEF

This audit did not identify any major breakdowns in the Los Angeles Unified School District's (district) controls over purchases and property. However, some structural weaknesses have exposed the district to higher costs and loss of property in a few areas. The district has corrected or is correcting the weaknesses that we identify in this report.

As a result of not exercising adequate internal controls over some of its purchases of supplies and equipment, the district exposed about 0.6 percent of its purchases to theft or fraud during fiscal years 1985-86 and 1986-87. Although we did not identify any specific losses, the Los Angeles District Attorney's Office is currently pursuing legal action regarding approximately \$1.25 million in thefts because of fraud that occurred in the district's Operations Branch. This fraud involved collusion among district employees and vendors, but we found that, because of weak controls, fraud could have occurred without collusion. Before and during our audit, the district issued new purchasing guidelines that strengthened its internal controls.

We also noted that the district did not adequately control some of its highly desirable and portable equipment, such as computers, typewriters, and video equipment, that are susceptible to theft. Further, we noted that the district did not always seek competitive estimates when purchasing supplies and equipment costing \$21,000 or less. By not seeking competitive estimates, the district may not be able to purchase supplies and equipment at the lowest possible cost. As a result of our review, the district issued revised procedures that re-emphasize the staff's responsibility to obtain and document competitive estimates.

BACKGROUND

The district purchases goods and services to operate and maintain its 818 schools and its administrative offices. Using a variety of methods, the district purchases its supplies and equipment from vendors either through its central Purchasing Branch or through each school and administrative office.

In April 1987, the director and deputy director of the district's Operations Branch were arrested for stealing from the district. The fraud was the result of collusion among district employees and various vendors to falsify purchases of supplies and equipment. Eleven persons have been convicted of crimes in connection with the fraud, the case against one person has been dismissed by the court, and the District Attorney's Office of Los Angeles County (District Attorney's Office) is currently pursuing legal action against another 12 persons involved in the fraud. As a result of the fraud, at least 17 employees either have been dismissed by the district or have resigned.

PRINCIPAL FINDINGS

The District's Controls in Procuring Some of Its Supplies and Equipment Were Inadequate

The district did not adequately control some of its procurement of supplies and equipment in accordance with the district's purchasing procedures and with effective internal controls. For 35 (18.7 percent) of our sample of 187 purchases through annual contracts and for 17 (8.7 percent) of our sample of 195 purchases of low-valued items, district employees requested purchases without different employees verifying that the district received the items purchased. Without verifying a separation of duties in the purchasing process, the district is not assured that it actually received the goods it purchased and therefore exposes its property to theft or fraud.

Although an adequate separation of duties does not guarantee that fraud will not occur, a separation of duties does minimize the risk of fraud. The fraud identified by the District Attorney's Office was the result of collusion among employees. However, by not verifying a separation of duties, fraud could occur even without collusion. Based on our samples of purchases, we estimate that the district exposed to fraud about \$3.3 million (0.6 percent) of its approximately \$557.7 million worth of purchases during fiscal years 1985-86 and 1986-87.

The district could not verify an adequate separation of duties because most of the district's procedures for purchases through annual contracts and purchases of low-valued items did not require evidence that more than one employee was involved in these purchases.

The district now requires verification of a separation of duties among employees who request, order, and receive items. Further, the district requires the accounts payable section to periodically review purchase orders to ensure that district employees adhere to the district's revised procedures.

The District Did Not Always Control Its Highly Desirable and Portable Property

Contrary to state law, district procedures, and effective internal controls, the district does not adequately control some of its highly desirable and portable property, such as computers, typewriters, and video equipment. These inadequate controls expose the district to loss or theft of property. Although we were able to locate all but 2 (2.4 percent) of the 84 equipment items in our sample, the existing conditions allow the opportunity for even greater loss.

Only one of the six schools and five administrative offices we visited maintained all of the required inventory records for our sample of 84 equipment items. In addition, one school and one office did not properly document

the transfer of items to other schools and offices, and two schools did not enforce the district's check-out, check-in policy when loaning items to employees. Further, 36 (69.2 percent) of the 52 sample items that we inspected and that the district requires be secured by locking devices did not have the devices, and 39 (50.6 percent) of the 77 items in our sample that we inspected were not engraved or otherwise permanently marked to provide a deterrent to theft, as the district recommends.

Some of the administrators at the schools and offices we visited attributed the inadequate controls over property to a variety of reasons including a high turnover of staff, a lack of awareness of the district's requirements, and a low priority for controlling property.

The District Did Not
Always Obtain Competitive
Estimates for Its Purchases
of \$21,000 or Less

District procedures require that its Purchasing Branch obtain competitive estimates when making purchases of \$21,000 or less. We reviewed 17 purchases of \$21,000 or less of supplies and equipment that are not stocked in the district's warehouses. However, the district did not have evidence that the Purchasing Branch obtained more than one price quotation for 8 (47.1 percent) of these 17 purchases.

By not obtaining competitive estimates, the district could give some vendors an unfair share of the district's business and may unnecessarily pay higher prices for supplies and equipment. We found that the district could have purchased an item for less money in one of the 8 cases in which we found no evidence that the district had obtained competitive estimates.

As a result of our review, the district issued revised procedures that re-emphasize the Purchasing Branch's responsibility to seek and document additional price quotations.

RECOMMENDATIONS

To exercise adequate internal controls over its contract purchases and its low-valued purchases, the district should comply with its revised procedures. These procedures require an adequate separation of duties among employees involved in the purchasing process and require the district's Accounts Payable Section to periodically review the district's purchases of supplies and equipment to ensure that an adequate separation of duties exists.

To adequately control its property, the district should ensure that the schools and administrative offices comply with existing state law and district procedures for maintaining inventory records, loaning property to employees, securing property, and engraving or permanently marking property. The district should also hold administrators accountable for controlling district property.

Finally, to exercise adequate control over obtaining and documenting competitive estimates for purchases of supplies and equipment, the district should periodically review the actions of the buying staff of the Purchasing Branch to ensure that the staff adhere to the district's revised procedures for competitive estimates.

AGENCY COMMENTS

The Los Angeles Unified School District generally concurs with the issues presented in the report. However, the district expressed concerns that the report does not fully recognize the district's alternative methods of securing highly desirable and portable property.

INTRODUCTION

The Los Angeles Unified School District (district) was created in 1960 and is governed by a seven-member board of education. In December 1986, the district operated 818 schools and other educational facilities with a total enrollment of approximately 720,000 students and with a staff of over 73,000 in its schools and administrative offices.

To operate and maintain its schools and offices, the district purchases goods and services from private vendors. During fiscal years 1985-86 and 1986-87, the district reported to its board of education that it purchased, or entered into contracts to purchase, approximately \$557.7 million in goods and services.

To purchase supplies and equipment through the district's Purchasing Branch, district employees must submit a requisition to the Purchasing Branch. The buying staff of the Purchasing Branch then purchase the items using either "stock purchase orders" to purchase items kept in stock in the district's warehouses or "nonstock purchase orders" to purchase items not stocked by the district. Further, the Purchasing Branch may issue both of these purchase orders to purchase items through contracts that the district has previously negotiated with vendors.

The district has three procurement methods to allow employees of the district's Maintenance Branch, Transportation Branch, and Operations Branch to purchase items that are used for particular jobs on which the employees are working. The employees may issue "contract purchase orders" to purchase items through prenegotiated contracts, and the employees may issue "job purchase orders" to purchase items that are not available through prenegotiated contracts. In addition, these employees may use "low-value purchase orders" to purchase items that are worth less than \$400, are needed immediately, and are not kept in stock by the district's warehouses. Employees may also use low-value purchase orders to rent equipment.

The "school purchase order" is another method the district uses to purchase supplies and equipment. Administrators in all schools and offices may use "school purchase orders" to purchase certain instructional materials of any value and to purchase nonstock supplies if the total amount of the purchase order does not exceed \$200. Through another procurement method, the Maintenance Branch may enter into contracts, which do not require purchase orders, with vendors to purchase goods and services. Finally, designated administrators in all schools and offices may use petty cash funds to purchase supplies and equipment.

In April 1987, the director and deputy director of the Operations Branch were arrested for stealing from the district. According to the district and the District Attorney's Office of

Los Angeles County (District Attorney's Office), the fraud involved collusion among employees and vendors that caused the district to pay for goods that it never received. The District Attorney's Office estimates that the fraud has cost the district approximately \$1.25 million. Fourteen employees, one retired employee, 2 relatives of employees, and 6 vendors have been arrested in connection with the fraud, and a warrant for the arrest of another district employee is pending. Of the 24 persons involved, 11 persons have been convicted of crimes in connection with the fraud, one person has been dismissed by the court, and the District Attorney's Office is currently pursuing legal action against the remaining 12 persons. Further, at least 17 employees either have been dismissed by the district or have resigned because of the fraud.

SCOPE AND METHODOLOGY

The purpose of this review was to evaluate the district's controls over its procurement of supplies and equipment. In addition, we evaluated the district's controls over the property that is stored in its warehouses and its controls over highly desirable and portable property that is located in schools and administrative offices. Further, we evaluated the district's compliance with state and district requirements for seeking competitive estimates.

To evaluate the adequacy of the district's internal controls over its procurement of supplies and equipment, we reviewed the district's procedures governing purchases. To evaluate the district's compliance with these procedures, we reviewed the purchasing methods that use stock purchase orders, nonstock purchase orders, contract purchase orders, job purchase orders, low-value purchase orders, school purchase orders, contracts, and petty cash funds. We also reviewed the audit work performed on petty cash funds by the district's internal audit unit to determine if we could rely on the audit unit as an internal control for petty cash expenditures. Further, after reviewing each type of purchase document and interviewing the district staff responsible for processing these documents, we constructed flow charts that illustrated each of the district's purchasing methods.

Among the purchasing methods that district employees used to perpetrate the fraud identified by the District Attorney's Office and, among the purchasing methods that appeared to have internal control weaknesses according to our flow charts, we reviewed a limited number of purchase documents to determine if control weaknesses existed. If we could identify internal control problems in our preliminary review, we increased the number of purchase documents that we reviewed. During our review, we found internal control weaknesses only in contract purchase orders and low-value purchase orders. Therefore, we increased the number of purchase documents that we reviewed to include samples of 187 contract purchase orders and 195 low value purchase orders that were processed for payment by the district during fiscal years 1985-86

and 1986-87. Finally, to determine the potential effect of the inadequate controls over contract purchase orders and low-value purchase orders, we estimated the total value of purchases that were exposed to theft or fraud during fiscal years 1985-86 and 1986-87.

To evaluate the district's controls over the property stored in its warehouses, we used the district's inventory records to trace items to the district's main warehouse. In addition, we physically inspected three of the district's warehouses to determine if the district adequately safeguards the property stored in the warehouses. Finally, we reviewed the district's procedures for its annual inventory of the property stored in the warehouses, and we reviewed the audit workpapers of a public accounting firm that audited the district's inventory in August 1986 to determine if we could rely on the district's inventory procedures and the accounting firm as controls over the district's warehouse inventory. Based on our limited review, we did not find problems that warranted further review.

To evaluate the district's controls over highly desirable and portable property located in schools and administrative offices, we reviewed state law and district procedures relating to the control of property. To determine whether the schools and offices complied with the state law and district procedures, we selected a sample of schools and offices and selected requisitions for equipment purchases submitted by the schools and offices during fiscal years 1985-86 and 1986-87. From these requisitions, we selected a sample of 84 highly desirable

and portable items and attempted to trace them to their locations at the schools and offices by examining inventory records and by interviewing administrators at each of the schools and offices. In addition, because some of these items were transferred to locations outside of our sample, we had to visit a school and an office that were not in our original sample of schools and offices to verify the existence of some of these items.

Finally, to determine whether the district's Purchasing Branch obtained competitive estimates when purchasing supplies and equipment and when negotiating contracts to purchase goods, we reviewed state law and district procedures relating to procurement and contracts. We then reviewed samples of 25 stock purchase orders, 25 nonstock purchase orders, and 20 contract purchase orders to evaluate the district's compliance with state law and district procedures. Based on our limited review, we did not find problems in the district's obtaining competitive estimates for stock and nonstock purchase orders valued at over \$21,000 and for contract purchase orders. To determine the effect of the district's failure to obtain competitive estimates for all of its purchases through stock purchase orders and nonstock purchase orders, we surveyed vendors in the Los Angeles area and compared the vendors' prices for certain items in our sample with the prices that the district paid for the same items.

AUDIT RESULTS

I

THE DISTRICT'S CONTROLS IN PROCURING SOME OF ITS SUPPLIES AND EQUIPMENT WERE INADEQUATE

As a result of not having adequate controls over some of its purchases of supplies and equipment during fiscal years 1985-86 and 1986-87, the Los Angeles Unified School District (district) exposed this property to theft or fraud. In purchases through annual contracts (contract purchase orders) and purchases of low-valued items (low-value purchase orders), district employees made purchases without different employees verifying that the district received the items purchased. Without verifying this separation of duties, the district is not assured that it actually received the goods that it purchased; therefore, the district exposes its property to theft or fraud. The District Attorney's Office of Los Angeles County (District Attorney's Office) is currently pursuing legal action regarding approximately \$1.25 million in thefts because of fraud that occurred in the district's Operations Branch. This fraud was the result of collusion among employees and vendors. However, without verifying a separation of duties, fraud could occur even without collusion. Based on our samples of purchases, we estimate that the district exposed to theft or fraud about \$3.3 million (0.6 percent) of its approximately \$557.7 million worth of purchases during fiscal years 1985-86 and 1986-87.

On January 22, 1987, the district's Internal Control Committee reported to the district's board of education a need to establish districtwide procedures for contract purchase orders and low-value purchase orders. On August 1, 1987, the district issued its procedures that require verification of a separation of duties between employees who make purchases and employees who receive the items purchased. Further, on October 1, 1987, the district issued procedures requiring the accounts payable section to periodically review purchase orders to ensure that district employees adhere to the district's revised procedures.

Inadequate Separation of
Duties Among Employees
Processing Purchase Orders

In the purchasing process, employees request items, order items, and receive items. To safeguard against fraud, effective internal controls require that, for any purchase, more than one employee be involved in this process. This separation of duties should occur before the accounts payable section processes the vendor's invoice and the receiving copy of the purchase order for payment. When only one employee is responsible for the entire purchasing process, the employee could purchase items and fraudulently divert the items for the employee's personal use. The district would then pay for items that are not used for district purposes. If different employees are involved in the purchasing process, each employee acts as a check

against the other employees; barring collusion between employees, a separation of duties minimizes the risk of fraud.

According to the head accountant in the district's Job Cost Accounting Section, district employees in the Maintenance Branch, Transportation Branch, and Operations Branch issued most of the district's contract purchase orders and low-value purchase orders during fiscal years 1985-86 and 1986-87. In testing for an adequate separation of duties in processing a purchase order, we determined whether sufficient evidence existed that more than one employee was involved in the purchasing process.

During fiscal year 1985-86, the district's Maintenance Procedure G-A-7 governed the processing of contract purchase orders in the Maintenance Branch. According to the division administrator of the Business Services Division, the Operations Branch also used this procedure during fiscal year 1985-86. During fiscal year 1986-87, the procedure was still in effect for the Maintenance Branch, but the Operations Branch no longer used contract purchase orders. During both fiscal years, the district's Automotive Maintenance procedure governed the processing of contract purchase orders in the Transportation Branch. Although both procedures required that more than one employee be involved in the purchasing process, the Maintenance Procedure G-A-7 did not require the signature or handwritten initials of all employees involved. Therefore, the Maintenance Procedure G-A-7 did not require verification of a separation of duties and could allow a single

employee to be responsible for requesting, ordering, and receiving items.

Of the 187 contract purchase orders in our sample, 35 (18.7 percent) did not have sufficient evidence that more than one employee was involved in the purchasing process. For the remaining 152 (81.3 percent) purchase orders, either the purchase orders and related documents contained the signatures or handwritten initials of two different employees or the district did not have the related documents. The district's procedures do not require the district to maintain such documents for more than one year.

During fiscal years 1985-86 and 1986-87, the district's Maintenance Procedure G-P-25 governed the processing of low-value purchase orders in the Maintenance Branch and the Transportation Branch. The Operations Branch used its Purchasing Guide #1 during fiscal year 1985-86 for low-value purchases. On May 20, 1986, the district issued to the Operations Branch a memorandum emphasizing the need for a separation of duties between employees who request items and employees who receive the items. On June 30, 1986, the Operations Branch issued its Guide 69, which governed the processing of low-value purchase orders, but, according to the financial analyst for the

Operations Branch, the Operations Branch no longer used low-value purchase orders after December 31, 1986. The Maintenance Procedure G-P-25, the May 20, 1986 memorandum, and the Operations Branch Guides #1 and 69 did not require evidence that more than one employee was responsible for requesting, ordering, and receiving items.

Of the 195 low-value purchase orders in our sample, 17 (8.7 percent) did not have sufficient evidence that more than one employee had been involved in the purchasing process. Each of the 17 purchase orders contained only one employee's signature, and, in 16 cases, the employee had signed the purchase order more than once.

The district lacked adequate controls over its contract purchase orders and low-value purchase orders because most of the district's procedures did not require verification of a separation of duties. In the Transportation Branch, the district's employees failed to always comply with the district's procedures that did require verification of a separation of duties, indicating that the district lacked control over its contract purchase orders.

As a result of not having adequate controls over its contract purchase orders and low-value purchase orders, the district exposed some of its property to theft or fraud. The fraud identified by the District Attorney's Office was largely the result of collusion among employees and vendors. However, the lack of controls we identified

would allow fraud even without collusion. By permitting an employee both to request a purchase and receive the items purchased without a different employee verifying that the items were received, the district risks having employees fraudulently indicate that the district received items that it actually had not received.

In our sample of 187 contract purchase orders, we found 35 (18.7 percent) that lacked evidence of an adequate separation of duties. Based on data provided by the district, the district processed for payment approximately \$12.4 million in contract purchase orders during fiscal years 1985-86 and 1986-87. If our sample is representative of all contract purchase orders, we estimate that the district exposed to theft or fraud approximately \$2.3 million during the two fiscal years.

In our sample of 195 low-value purchase orders, we found 17 (8.7 percent) that lacked evidence of an adequate separation of duties. Based on data supplied by the district, the district processed for payment approximately \$11.6 million in low-value purchase orders during fiscal years 1985-86 and 1986-87. If our sample is representative of all low-value purchase orders, we estimate that the district exposed to theft or fraud approximately \$1.0 million during the two fiscal years.

Thus, based on our samples of purchases, we estimate that the district exposed to theft or fraud approximately \$3.3 million (0.6 percent) of its approximately \$557.7 million worth of purchases during fiscal years 1985-86 and 1986-87.

Corrective Action

On January 22, 1987, the district's Internal Control Committee reported to its board of education a need to establish districtwide procedures for contract purchase orders and low-value purchase orders. On August 1, 1987, the district issued the procedures for processing contract purchase orders and low-value purchase orders. The new procedures clearly require verification of a separation of duties among district employees involved in the purchasing process. The procedures require that these employees sign the copies of the purchase orders before sending them to the accounts payable section for processing for payment. Finally, on October 1, 1987, the district issued procedures requiring the accounts payable section to periodically review contract purchase orders and low-value purchase orders to ensure that an adequate separation of duties exists.

CONCLUSION

Because of inadequate internal controls in its purchasing process, the district exposed some of its property to theft or fraud during fiscal years 1985-86 and 1986-87. The district

lacked evidence of a sufficient separation of duties in 35 (18.7 percent) of our sample of 187 contract purchase orders and in 17 (8.7 percent) of our sample of 195 low-value purchase orders because most of the district's procedures did not require verification of a separation of duties among employees. Further, in the Transportation Branch, the district's employees did not always adhere to procedures that did require verification of a separation of duties. We estimate that the district exposed to theft and fraud about \$3.3 million (0.6 percent) of its approximately \$557.7 million in total purchases during fiscal years 1985-86 and 1986-87.

RECOMMENDATION

To exercise adequate internal controls over its contract purchase orders and low-value purchase orders, the district should ensure that all its employees adhere to the district's revised procedures. These procedures require verification of a separation of duties among employees involved in the purchasing process and require the accounts payable section to periodically review employees' purchases of supplies and equipment to ensure that an adequate separation of duties exists.

II

THE DISTRICT DID NOT ALWAYS CONTROL ITS HIGHLY DESIRABLE AND PORTABLE PROPERTY

Contrary to state law, district procedures, and effective internal controls, the district does not adequately control some of its highly desirable and portable property, such as computers, typewriters, and video equipment. Although we were able to locate all but 2 (2.4 percent) of the 84 items in our sample, the existing conditions allow for greater loss. Only one of the six schools and five administrative offices we visited maintained all of the required inventory records for our sample of 84 items. In addition, one school and one office did not properly document the transfer of items to other locations, and two schools did not enforce the district's check-out, check-in policy when loaning items to employees. Further, 36 items in our sample that the district required to be secured by locking devices and that we could inspect, did not have the devices. Moreover, 39 of the items that we could inspect and that the district recommended to be engraved or otherwise permanently marked as a deterrent to theft were not engraved or otherwise marked.

Without adequately controlling property, the district cannot minimize the unaccountable loss or theft of district property for which the district must spend funds to replace. The two items we could not locate, a computer keyboard and computer monitor screen, are the major

components of a system valued at \$682. Although the dollar value of these losses is relatively small, the losses are based upon only a limited review and illustrate that inadequate controls over property allow such losses to occur.

Inadequate Internal Controls Over District Property

The California Education Code, Section 35168, requires that districts establish and maintain inventory records of equipment items that have a current market value exceeding \$500. For each of the items, the inventory record must include, for example, the item's name and description, identification number, original cost, date of acquisition, and the location of the item. In addition, the district's procedures, as outlined in Business Services Division Bulletin 24, require that schools and offices maintain this information on inventory cards for all items having an original purchase price of \$200 or more. The district's procedures also require that schools and offices maintain an annual inventory listing of all items located at each school or office.

Only one of the six schools and five administrative offices that we visited maintained all of the required inventory records for the 84 property items in our sample. No inventory cards existed for 43 (51.2 percent) of the 84 items we attempted to trace. Ten of the 43 items were valued at more than \$500. Thus, the lack of inventory cards for these 10 items violated both state law and district procedure. In

addition, only one school and two offices had inventory cards for all of the items that we traced to those locations, and three of the schools and two of the offices did not even keep the required inventory cards for equipment.

In addition to inadequate inventory cards, the annual inventory listings that the schools and offices maintained at the end of fiscal year 1986-87, included only 25 (29.8 percent) of the 84 items in our sample. One school's listing included only 4 (16.7 percent) of the 24 items that we attempted to trace to the school. This school also needed several days to produce most of the 24 items that we attempted to trace, yet it still could not produce 2 of the items. Further, one school and one office transferred items to other locations without documenting the transfers. To verify the existence of these items, a video cassette recorder and a computer printer, we had to rely on the memories of people at the original school and office from which these items were transferred, and we had to visit the school and office to which the items were transferred. Table 1 shows the number of items that we located in our sample and the degree of compliance of each school and office with the requirements for inventory records.

TABLE 1

THE NUMBER OF ITEMS THAT WE LOCATED
AND THE INVENTORY RECORDS KEPT BY SCHOOLS
AND ADMINISTRATIVE OFFICES THAT WE VISITED

<u>School or Administrative Office</u>	<u>Number of Items In Sample</u>	<u>Number of Items We Located</u>	<u>Number of Items With Inventory Cards</u>	<u>Number of Items on Annual Inventory Lists</u>
San Gabriel Avenue School	8	8	--	3
Trinity Street School	2	2	--	--
Hoover Street School*	24	22	--	4
Tenth Street School	7	7	3	3
Montague Street School	20	20	20	2
Grant Street School	11	11	10	8
Central Educational Support Center*	2	2	--	--
School Planning Branch	1	1	1	1
Technical Support Section, Central Shops	7	7	7	3
Maintenance Area 3	1	1	--	1
Room 304, Building Services Division	<u>1</u>	<u>1</u>	<u>--</u>	<u>--</u>
Totals	<u>84</u>	<u>82</u>	<u>41</u>	<u>25</u>

* Hoover Street School and the Central Educational Support Center each transferred an item to a location that we did not originally identify as having any of the 84 items in our sample. We visited each of these two locations only to verify the existence of the two items in our sample.

The district's School Board Rule 1704 holds teachers and employees, who are under the direction of the principals, responsible for the care of school property. In accordance with this rule, the district has established a check-out, check-in policy that requires staff to sign a property receipt form whenever the staff remove property from a school's premises.

Three of the six schools that we visited indicated that they had loaned to their employees some of the items from our sample of 84 items. However, two of these schools did not enforce the district's check-out, check-in policy. In one school, the principal and assistant principal had computer equipment at their homes, yet they had not completed the district forms that gave them permission to remove district property from the school's premises. In another school, a district employee had not completed the required district forms for checking out computer equipment that he uses in five different schools. In each of the two cases in which the schools did not enforce the check-out, check-in policy, we verified the existence of the items that the schools loaned out.

The district's procedures, as outlined by Business Services Bulletin 15, require that administrators adequately secure property, and the district's equipment catalogs for 1985 and 1986 require that schools and offices secure equipment such as computers and electronic typewriters with locking security devices. On October 5, 1984, the district's director of Central Planning Facilities issued a

districtwide memorandum stating that the Maintenance Branch must install locking security devices on all items identified in the district's equipment catalog as requiring the security devices.

Of the 84 equipment items in our sample, the equipment catalogs required that schools and offices lock 58 of the items with security devices. Of the 58 items, we inspected only 52 items because we could not locate 2 of the items and because one school loaned out 4 of the items. Of the 52 items, 36 (69.2 percent) did not have the required security devices.

In addition to requiring adequate security for equipment, effective internal controls require that, as a deterrent to theft, schools and offices should permanently mark highly desirable and portable equipment items so that the items are readily identified as district property. Moreover, the district's procedures, as outlined by Business Services Bulletin 15, suggest that the administrators mark items that are susceptible to theft to prevent the loss of the items. Further, the district's Operating Memorandum 1 recommends that, as a deterrent to theft, administrators engrave equipment items that are purchased for specific programs.

Of the 84 items in our sample, we inspected only 77 because we could not locate 2 of the items and because one school loaned out 5 of the items. Of the 77 items we inspected, 39 (50.6 percent) were not engraved or otherwise permanently marked.

The district's School Board Rule 1703 and Business Services Bulletin 15 assign responsibility for controlling property to the administrators. However, the schools and offices do not maintain the required inventory records, do not always require staff who borrow items to sign receipts for loaned property, and do not properly secure and mark property items, indicating that the district does not adequately monitor the administrators. Some of the administrators at the schools and offices that we visited attributed the lack of controls over property items to a variety of reasons. For example, according to one of the administrators, the inadequate controls were the result of a high turnover of staff at the schools. Another administrator stated that controlling property is a low priority. Further, two other administrators stated that they were unaware of the district's requirement for inventory cards. In our opinion, if the district monitored administrators to determine whether the administrators are meeting their responsibilities so that the district can hold administrators accountable for district property, the schools and offices would exercise adequate controls over property.

When the district does not adequately control its property, the district cannot minimize the unaccountable loss or theft of the property. Although we were able to locate all but 2 (2.4 percent) of the 84 items in our sample, the existing conditions allow for greater loss, and the district must then spend funds to replace the lost or stolen property. The two items we could not locate, a computer keyboard

and computer monitor screen, are the major components of a system valued at \$682. Although the dollar value of these losses is relatively small, the losses are based upon only a limited review and illustrate that inadequate controls over highly desirable and portable property allow such losses to occur.

CONCLUSION

The Los Angeles Unified School District does not adequately control all of its highly desirable and portable property in accordance with state law, district procedures, and effective internal controls. Only one of the six schools and five offices that we visited maintained all of the required inventory records for our sample of 84 property items. Further, the schools and offices do not always require that staff sign receipts for loaned property; neither do they always use required security devices nor permanently mark property items as a deterrent to theft. By not adequately controlling its property, the district cannot minimize the unaccountable loss or theft of the property. Although the administrators at some of the schools and offices attributed the lack of controls to a variety of reasons, we believe that, if the district held administrators accountable for controlling property, schools and offices in the district would exercise adequate controls over property.

RECOMMENDATIONS

To adequately control its property, the Los Angeles Unified School District should take the following actions:

- Ensure that the schools and administrative offices comply with existing state law and district procedures for maintaining inventory records, monitoring property loans, securing equipment, and engraving or permanently marking equipment; and
- Hold administrators accountable for controlling district property.

III

THE DISTRICT DID NOT ALWAYS OBTAIN COMPETITIVE ESTIMATES FOR ITS PURCHASES OF \$21,000 OR LESS

Although district procedures require that the district's Purchasing Branch obtain competitive estimates when making purchases of \$21,000 or less, the district did not have evidence that the Purchasing Branch obtained more than one price quotation for 8 (47.1 percent) of the 17 purchases that we reviewed of supplies and equipment that are not stocked in the district's warehouses. The Purchasing Branch made the 17 purchases during fiscal years 1985-86 and 1986-87. By not obtaining competitive estimates, the district could be giving some vendors an unfair share of the district's business, and the district may unnecessarily pay higher prices for supplies and equipment. Moreover, we found that the district could have purchased an item for less money in one of the 8 cases in which no evidence existed that the district obtained competitive estimates.

As a result of our review, the district issued revised procedures that re-emphasize the responsibility of the Purchasing Branch to seek and document additional price quotations.

Failure to Obtain
Price Quotations
From More Than One Vendor

The district's Purchasing Section Instruction 3:03:02 required that the buying staff of the Purchasing Branch obtain at least two price quotations when purchasing supplies and equipment valued at \$21,000 or less. According to the director of the Purchasing Branch, the procedures further required that the buying staff document the quotations by recording information such as the vendor's name and the price that the vendor quoted. However, in some instances, the buying staff is unable to obtain additional price quotations--for example, when only one vendor offers a particular item. If the buying staff did not obtain more than one price quotation, the buying staff had to obtain the approval of either the Purchasing Branch director or the deputy branch director.

We reviewed 17 nonstock purchase orders that the Purchasing Branch made during fiscal years 1985-86 and 1986-87. Of these 17, 8 (47.1 percent) did not contain evidence that the district sought additional price quotations. The Purchasing Branch director acknowledges that the district's buying staff did not seek additional price quotations for 2 of the 8 purchases, an industrial battery and a portable circular saw. However, the Purchasing Branch director was unable to explain why the buying staff did not seek additional price quotations. For another 3 of these 8 purchases, the Purchasing Branch

director contends that the buying staff sought additional price quotations but failed to document these quotations. For an additional 2 of these 8 purchases, the Purchasing Branch director stated that the buying staff had sought competitive estimates and had documented those estimates, but because the district purges its files of that documentation one year after the purchase, the documentation no longer exists.

For the remaining purchase of the 8 purchases and for an additional purchase from the 17 nonstock purchase orders that we reviewed, the Purchasing Branch director stated that special circumstances allowed the buying staff to purchase from a particular vendor but that the buying staff failed to obtain the necessary approval from either the Purchasing Branch director or the deputy branch director.

Of the 11 stock purchase orders that we reviewed, the buying staff appeared to have sought additional price quotations for 7 of the purchases, and 3 of the purchases appeared to have special circumstances allowing the buying staff to purchase from a particular vendor. However, all 3 of these purchase orders should have contained the approval of either the branch director or the deputy branch director but did not contain the approvals. These 3 purchase orders were for pamphlet files, forms, and desk maps.

If the buying staff is seeking additional price quotations but is not documenting them, then the Purchasing Branch either is not adequately monitoring the actions of its buying staff or is not adequately training its buying staff about proper documentation. The Purchasing Branch director acknowledged that the director and deputy director of the Purchasing Branch are responsible for monitoring whether the buying staff is complying with Purchasing Branch internal procedures for obtaining competitive estimates; however, the director and deputy director did not adequately monitor the buying staff or delegate the monitoring functions to other branch personnel for purchases of \$21,000 or less. The Purchasing Branch director stated that, in the future, branch operations personnel will be assigned the task of monitoring whether the buying staff documents additional price quotations for these purchases. He further stated that, while the branch management has constantly reminded the buying staff of their responsibility to document all price quotations, the branch management may not have placed an equal emphasis on the responsibility of the buying staff to get approval from the branch director or deputy branch director when obtaining only one price quotation for purchases of \$21,000 or less.

By not seeking price quotations from more than one vendor, the district could give an unfair advantage to the vendors from whom the district purchases its supplies and equipment, and the district limits the opportunities for other vendors to sell their merchandise to the district. In addition, by not obtaining competitive estimates, the

district may unnecessarily pay higher prices for supplies and equipment. Based on a price comparison for items purchased by the district in the 8 cases in which there was no evidence that the district sought additional price quotations, we found that, in one of the 8 cases, the district could have purchased an item for less money from one of the vendors that we surveyed. In the one case, the district paid \$1,200 for an industrial battery. The vendor that we surveyed quoted us a price of \$1,075 for the same type of battery--\$125 less than what the district paid for the battery. Although the savings we identified are relatively small, the amount is based upon limited testing and illustrates that the district can save money when it obtains competitive estimates for its purchases.

Corrective Action

As a result of our review, the district issued to the buying staff of the Purchasing Branch revised procedures that re-emphasize the buying staff's responsibility to seek and document additional price quotations for purchases of \$21,000 or less. Further, the revised procedures clarify when approval from the branch director or deputy branch director is necessary.

CONCLUSION

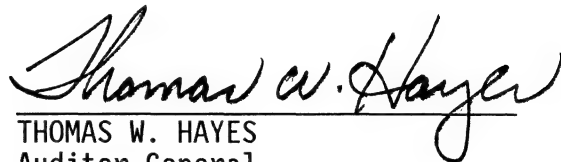
For some of the district's purchases made during fiscal years 1985-86 and 1986-87, the buying staff of the Purchasing Branch did not obtain competitive estimates as required by district procedures. Of the 17 nonstock purchases that we reviewed, the district did not have evidence that the buying staff obtained additional price quotations in 8 (47.1 percent) of the purchases. Because the Purchasing Branch has no method of monitoring the staff's actions, the buying staff could choose not to follow the district's procedures for obtaining competitive estimates. By not obtaining competitive estimates for its purchases, the district could give an unfair advantage to the vendors from whom the district purchases its supplies and equipment, and the district may unnecessarily pay higher prices for supplies and equipment.

RECOMMENDATION

To exercise adequate control over obtaining and documenting competitive estimates for purchases of supplies and equipment, the district should periodically review the actions of the buying staff of the Purchasing Branch to ensure that the staff adhere to the district's revised procedures for competitive estimates.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,


THOMAS W. HAYES
Auditor General

Date: December 21, 1987

Staff: Thomas A. Britting, Audit Manager
Michael R. Tritz
Linda W. Lindert
Susan L. Wynsen
Eric D. Thomas

Los Angeles Unified School District

BUSINESS AND FINANCE OFFICE

ADMINISTRATIVE OFFICES: 450 N. GRAND AVENUE, LOS ANGELES, CALIFORNIA 90012

MAILING ADDRESS: BOX 3307, LOS ANGELES, CALIFORNIA 90051

TELEPHONE: (213) 625-4032

LEONARD M. BRITTON
Superintendent of Schools

ROBERT BOOKER
*Chief Business and
Financial Officer*

December 17, 1987

Mr. Thomas W. Hayes
Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Hayes:

At the request of a member of the Joint Legislative Audit Committee, the Office of the State Auditor General advised us on May 26, 1987, of its intention to conduct a review of procurement processes of the Los Angeles Unified School District. Up to five auditors from the Auditor General's Office spent approximately six months auditing the District. Although the audit manager could not tell us how much staff time had been spent on the audit, we estimate that at least \$100,000 of taxpayer funds were expended on this review. (1)*

We would like to observe that the District's practices are continuously monitored by its Internal Audit staff, its independent outside accounting firms, and auditors from: the State Controller's Office, the State Department of Education, the State Allocation Board, the Federal Office of Education, the United States Department of Agriculture and auditors hired by the City and County of Los Angeles. The District has always welcomed suggestions from these auditors on how to improve its procedures, practices, and internal controls.

We are pleased that the Auditor General's report validates the adequacy of the District's procurement practices. The Auditor General, after spending almost six months reviewing all of the District's procurement practices for the two fiscal years, 1985-86 and 1986-87, identified no losses and found that 99.4% of the District's \$557.7 million in purchases for the two years had adequate controls. The District appreciates the Auditor General's comments regarding the other 0.6% of purchases and, in fact, has already implemented changes to insure that the District has adequate control over all purchases.

The District also is pleased that of the 84 highly desirable and portable items the Auditor General's staff looked for, they found all but two. Only one of these items is still "missing" and even that one may be accounted for by the time this report is released. In addition, the Auditor General was able to find only one item which may have been obtained at a lower cost, although the vendor they identified was located outside of the County of Los Angeles. The availability of this item within Los Angeles County would not normally warrant seeking quotations from vendors outside the County. (2)

*The district's response contains a number of inaccuracies and misrepresentations of fact, each of which is identified by footnotes. The Auditor General has responded to these inaccuracies on page 37.

We have a number of specific comments relating to this report which follow:

1. Auditors Found 99.4% of District Purchases to have Adequate Controls

According to the audit findings, over ninety-nine percent (99%) of the District's purchases were made through competitive bidding, processed through central warehouses, or controlled by other systems which insure the integrity of these transactions. The District believes that procedures dealing with the other 0.6% of purchases provided for adequate separation of the ordering and receiving functions. However, revised written procedures were issued which more clearly document this separation of duties. (3)

2. New Procedures Could Not Have Prevented Operations Branch's Fraud

Staff of the Office of the Auditor General conceded that even if the changes in District procedures had been fully implemented at the time of the improprieties in the Operations Branch, these new procedures could not have prevented the collusion which took place within that branch. (4)

3. Ninety-Nine Percent of "Highly Desirable and Portable" Equipment Located

The staff of the Auditor General's Office selected a sample of what they described as "highly desirable and portable" property which they traced through the procurement processes to District schools and offices. Ninety-eight percent of the items were located or accounted for by the auditors. The two items which the auditors could not locate (a computer keyboard valued at \$350 and a computer monitor screen valued at \$70) were shipped to an elementary school location for instructional use. After the auditor advised the District on December 10, 1987 of the specific items they could not locate, the "missing" keyboard was located by the District's Internal Audit staff the next day, thus bringing the percentage of items accounted for to 99%. School personnel are continuing their efforts to locate the remaining item. (5)

4. Significant Portions of District's "Highly Desirable and Portable" Equipment in Secured Areas

The auditors failed to recognize in their report that significant portions of the District's computers and other equipment are stored in secured areas. For example, school computer laboratories located on the first floor of a building generally have barred windows, reinforced doors, and security monitoring devices which alert the District's police force of an unauthorized intrusion. Other "highly desirable and portable" equipment such as typewriters and VCRs are frequently stored in secured closets. (6)

5. District Inventory Systems More Exacting than State Laws Require

While the State law requires inventory records be maintained for equipment with a value of \$500 or more, the District procedures require these records for items with a value of \$200 or greater. The District has and will continue to emphasize to site administrators their responsibility for securing and inventorying equipment at their site. (7)

6. District Purchases in Compliance with Competitive Bidding Laws

Items for which the auditors could not locate evidence of more than one price quotation were all items well below the legal competitive bidding limit. In other words, by law these items were not subject to competitive bidding process. Purchases which are below the competitive bidding limit account for only a small percentage of the District's purchases.

Further, the report indicates that one item in their sample could have been purchased for less money. However, it fails to disclose that the allegedly lower price quotation was obtained from a vendor who is not even located within the County of Los Angeles. The availability of this item within Los Angeles County would not warrant seeking quotations from vendors outside the County. Nonetheless, the District has reissued procedures to address concerns relating to the documentation of competitive price quotations for items under the legal bid limit. (8)

This positive audit report illustrates the advantage of the District's size in maintaining internal controls. The District, because of its size, can easily separate the ordering, receiving, and buying functions. Whereas, many small districts may have only one or two responsible persons performing these functions and certainly would not have the leverage to obtain the best prices for their districts' supplies and materials. The District's purchasing power alone is larger than most California school districts' entire budgets.

It should be noted that the District was awarded Certificates of Achievement for Excellence in Financial Reporting by the Government Finance Officers Association (GFOA) of the United States and Canada. Further, the Association of School Business Officials (ASBO) has awarded Certificates of Excellence in Financial Reporting to the District. In receiving these awards, the District is recognized as having met the highest standard of excellence in financial reporting. (9)

We appreciate this opportunity to comment on this report by the Office of the Auditor General.

Sincerely,



Leonard M. Britton
Superintendent



Robert Booker
Chief Business and Financial Officer

LMB:RB:DWK:vf

cc: Members, Los Angeles City Board of Education

**AUDITOR GENERAL'S COMMENTS ON THE
LOS ANGELES UNIFIED SCHOOL DISTRICT'S RESPONSE**

- ① A number of statements in this paragraph are incorrect. First, the requester of the audit is not, and has never been, a member of the Joint Legislative Audit Committee. The audit was requested after identification of a fraud of approximately \$1.25 million involving numerous district employees and private vendors. All 14 members of the bipartisan, bicameral, Joint Legislative Audit Committee approved the audit. In addition, the manager would not discuss the cost of the audit with district officials because it is not pertinent to the inadequate controls identified, but only three auditors and a summer intern worked on this audit, and the cost is significantly less than the district's \$100,000 estimate. Further, the district will not be billed for any audit costs.
- ② In the last two paragraphs of the first page of the response, the district summarizes a number of comments from our audit report that we believe are misrepresentations of fact or incorrect statements. Our responses to the district's specific comments are detailed in items 3 through 9 below.
- ③ We state on page 13 of our report that the district exposed to theft or fraud about 0.6 percent of the district's purchases during fiscal years 1985-86 and 1986-87. Although this percentage is relatively small, it represents an estimated \$3.3 million because this district is the largest in California and had \$557.7 million in purchases during fiscal years 1985-86 and 1986-87.
- ④ This statement misrepresents the facts. The audit staff did not concede that the new procedures could not have prevented the collusion that occurred in the district's Operations Branch because we recognize the generally accepted principle of internal controls that designing cost-effective internal controls to prevent collusion is virtually impossible. However, as we state on page S-3 of our report, although an adequate separation of duties does not guarantee that fraud will not occur, a separation of duties does minimize the risk of fraud.
- ⑤ The district's characterization of the events regarding the lost property is incorrect. On September 2, 1987, we searched for the missing computer equipment with the administrator responsible for controlling the equipment. The items could not be found. During subsequent contacts with the district on September 11, November 24 and 25, and December 10, 1987, we advised the district that the two items were still missing. After searching for the items for over three months, the district still could not locate them. On December 12, 1987, after our fieldwork was completed, the district sent us a memorandum stating that they had found the missing keyboard. However, we cannot verify that the keyboard was actually found. If the district had followed its own procedures for controlling equipment, the loss of equipment may have been avoided.

- ⑥ The fact that some of its equipment is secure fails to address the district's not following its own procedures for securing the items discussed in our report. These procedures state unequivocally that the requirement for lockdown devices "is mandatory."
- ⑦ This statement misrepresents the facts. Thirty (35.7 percent) of the 84 items in our sample were valued at over \$500. The district did not comply with state law for 10 of these items.
- ⑧ This statement misrepresents the facts. The vendor we contacted is listed in the Los Angeles telephone directory for businesses, and is located adjacent to Los Angeles in Santa Ana. Also, the district's procedures do not restrict purchases to vendors located only in Los Angeles County. The person we spoke with is the sales representative for Los Angeles and quoted us a price that was lower than the price that the district had paid for the same item. The failure to obtain competitive estimates illustrates the potential waste that the district can incur if the district does not obtain the best price for its purchases.
- ⑨ While the district should be commended for receiving awards for its past financial reporting, it should maintain vigilance in the management of its procurement practices and internal controls to assure that another \$1.25 million fraud or similar loss does not occur.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps